DUDLEY KNOX LIBRARY
NAVAL POSTGRADUATE SCHOOL
MONTEREY, CALIF. 93940

NPG - 166

NAVAL POSTGRADUATE SCHOOL
Monterey, California

THESIS

Centralized Accounting and Disbursing
for Foreign Military Sales
Direct-Cite Procurements: Test Evaluation

by

Roger Allen Willis

September 1981

Thesis Advisor: William H. Cullin

Approved for public release; distribution unlimited

T204486

SECURITY CLASSIFICATION OF THIS PAGE (When Data Entered)

REPORT DOCUMENTATION PAGE

READ INSTRUCTIONS BEFORE COMPLETING FORM

1. REPORT NUMBER

2. GOVT ACCESSION NO.

3. RECIPIENT'S CATALOG NUMBER

4. TITLE (and Subtitle)

Centralized Accounting and Disbursing for Foreign Military Sales Direct-Cite Procurements: Test Evaluation

5. TYPE OF REPORT & PERIOD COVERED
Master's Thesis
September 1981

6. PERFORMING ORG. REPORT NUMBER

7. AUTHOR(s)

Roger Allen Willis

8. CONTRACT OR GRANT NUMBER(s)

9. PERFORMING ORGANIZATION NAME AND ADDRESS

Naval Postgraduate School
Monterey, California

10. PROGRAM ELEMENT, PROJECT, TASK AREA & WORK UNIT NUMBERS

11. CONTROLLING OFFICE NAME AND ADDRESS

Naval Postgraduate School
Monterey, California 93940

12. REPORT DATE
September 1981

13. NUMBER OF PAGES
88

14. MONITORING AGENCY NAME & ADDRESS(if different from Controlling Office)

15. SECURITY CLASS. (of this report)
Unclassified

15a. DECLASSIFICATION/DOWNGRADING SCHEDULE

16. DISTRIBUTION STATEMENT (of this Report)

Approved for public release; distribution unlimited.

17. DISTRIBUTION STATEMENT (of the abstract entered in Block 20, if different from Report)

18. SUPPLEMENTARY NOTES

19. KEY WORDS (Continue on reverse side if necessary and identify by block number)

Foreign Military Sales (FMS)
Centralization
Financial Management

20. ABSTRACT (Continue on reverse side if necessary and identify by block number)

Foreign military sales (FMS) have grown significantly in dollar volume. The General Accounting Office has accused the Department of Defense (DOD) of a longstanding inability to manage the FMS program, and recently recommended centralization of accounting and disbursing functions as the best long-range solution to the program's problems. Defense subsequently initiated the limited test of centralization at the Security

DD FORM 1 JAN 73 1473 EDITION OF 1 NOV 65 IS OBSOLETE
S/N 0102-014-6601

UNCLASSIFIED
SECURITY CLASSIFICATION OF THIS PAGE (When Data Entered)

Assistance Accounting Center. The test involves several major direct-cite procurement contracts, and was designed to form the basis of DOD's response to the Congress regarding the centralized concept. This thesis describes and evaluates this ongoing test, in particular, its relevancy towards the decison of whether or not to expand and implement centralization of the FMS program. The study concludes that, although centralization is not a panacea for all the problems of the U.S. foreign military sales program, and cannot be expected to produce instant solutions, it is an advancement. Until a better alternative is developed, centralization should be pursued.

Approved for public release; distribution unlimited.

Centralized Accounting and Disbursing for Foreign Military Sales Direct-Cite Procurements: Test Evaluation

by

Roger Allen Willis
Lieutenant Commander, Supply Corps, U.S. Navy
B.S., Ohio State University, 1970

Submitted in partial fulfillment of the
requirements for the degree of

MASTER OF SCIENCE IN MANAGEMENT

from the

NAVAL POSTGRADUATE SCHOOL
September 1981

DUDLEY KNOX LIBRARY
NAVAL POSTGRADUATE SCHOOL
MONTEREY, CALIF, 93940

ABSTRACT

Foreign military sales (FMS) have grown significantly in dollar volume. The General Accounting Office has accused the Department of Defense (DOD) of a longstanding inability to manage the FMS program, and recently recommended centralization of accounting and disbursing functions as the best long-range solution to the program's problems. Defense subsequently initiated a limited test of centralization at the Security Assistance Accounting Center. The test involves several major direct-cite procurement contracts, and was designed to form the basis of DOD's response to the Congress regarding the centralized concept. This thesis describes and evaluates this ongoing test, in particular, its relevancy towards the decision of whether or not to expand and implement centralization of the FMS program. The study concludes that, although centralization is not a panacea for all the problems of the U.S. foreign military sales program, and cannot be expected to produce instant solutions, it is an advancement. Until a better alternative is developed, centralization should be pursued.

TABLE OF CONTENTS

I. INTRODUCTION ---------- 9

A. BACKGROUND INFORMATION ---------- 9

B. ISSUES ---------- 10

C. OBJECTIVES AND SCOPE OF STUDY ---------- 12

D. RESEARCH METHODOLOGY ---------- 13

E. ORGANIZATION ---------- 13

II. BACKGROUND OF FMS ---------- 15

A. HISTORY ---------- 15

B GROWTH OF FMS ---------- 16

C. CREATION OF THE SAAC ---------- 17

III. ACCOUNTING FOR FMS ---------- 20

A. REQUIREMENTS ---------- 20

B. PRICING ---------- 22

C. FMS TRUST FUND ---------- 24

D. FINANCIAL ADMINISTRATION AND CONTROL ---------- 26

E. FINANCING AND FLOW OF FUNDS ---------- 27

F. BILLINGS TO FOREIGN GOVERNMENTS ---------- 29

IV. FMS PROBLEMS DISCLOSED ---------- 32

A. FMS POLICY IMPLEMENTATION ---------- 32

B. COST RECOVERY IN FMS ---------- 33

C. FMS TRUST FUND DIFFERENCES ---------- 38

D. OTHER PROBLEMS ---------- 40

1. Expenditure Projections ---------- 40

2. FMS Delivery and Performance Reporting ----- 41
3. Progress Payments ----- 41
4. Personnel Problems ----- 41
V. CENTRALIZATION CONCEPT ----- 43
A. GAO SOLUTION ----- 43
B. ADVANTAGES AND DISADVANTAGES ----- 44
C. SUBSEQUENT ACTION ----- 45
VI. CENTRALIZATION TEST--DEVELOPMENT ----- 46
A. INCEPTION ----- 46
1. GAO Recommendations ----- 46
2. Congressional Direction ----- 47
3. Defense Response ----- 48
B. INITIAL TEST PLAN ----- 49
1. Objectives ----- 49
2. Milestones ----- 49
3. Contract Transfer Process ----- 51
4. Operating Procedures ----- 52
a. Transfer of Authority ----- 52
b. Accountability ----- 53
c. Files and Ledgers ----- 53
d. Performance Reporting ----- 54
e. Management Feedback Reporting ----- 54
f. Contract Involvement ----- 55
C. TEST REVISIONS ----- 55
1. Expansion ----- 55

2. Extension ---------- 56
3. Automation ---------- 57
4. Performance Reporting ---------- 59
5. Manpower Study ---------- 61
6. Economic Analysis ---------- 64
D. CURRENT STATUS ---------- 65
VII. CENTRALIZATION TEST--EVALUATION ---------- 67
A. BASIC ORGANIZATION ---------- 67
1. Background and Basis of Test ---------- 67
2. Test Objectives ---------- 67
B. EVOLUTION ---------- 68
C. RESULTS ---------- 68
1. Disbursements ---------- 68
2. Feedback Reporting ---------- 69
3. Contract Funding ---------- 70
4. Problems ---------- 70
5. Objective Achievement ---------- 72
a. Feasibility ---------- 72
b. Resource Determination ---------- 72
c. Advantages/Disadvantages ---------- 73
d. System Development ---------- 74
e. Degree of Centralization ---------- 75
D. RATIONALE FOR CENTRALIZATION ---------- 75

VIII. SUMMARY, CONCLUSIONS, AND RECOMMENDATIONS --------- 77

APPENDIX A - GLOSSARY OF ACRONYMS ---------- 82

LIST OF REFERENCES ---------- 84

INITIAL DISTRIBUTION LIST ---------- 88

I. INTRODUCTION

A. BACKGROUND INFORMATION

United States foreign policy since World War II has been to provide military assistance to friendly foreign countries. The growth in foreign military sales (FMS) in the past several years has been astonishing. Although the program has been in existence for almost thirty years, annual FMS orders did not exceed the billion dollar level until the late 1960's. Since 1974, annual sales have consistently surpassed $10 billion. The last two years have seen sales in the $15 billion area. [Ref. 1]

FMS has become "big business". Along with a rapid growth in sales there has been a nightmarish list of problems in accounting and control. So much so that in 1976, the Security Assistance Accounting Center (SAAC) was established for the purpose of being the executive for the Department of Defense (DOD), singularly responsible for billing and collecting all monies due under the FMS program. Despite improvements in many areas since the inception of SAAC, accounting for FMS continues to be plagued by problems. The General Accounting Office (GAO) and defense audit agencies have issued numerous reports on the quality and management of the FMS program. Generally speaking, the reports have been critical, with the major area of criticism being DOD's

inadequate financial accounting system. In a Business Week article it was alleged that the Department of Defense had "lost track of up to $30 billion (in FMS)" [Ref. 2]. It stated that the DOD accounting system was so unkempt, disorganized, and inadequate, that it was not able to determine whether those unaccounted-for FMS monies were the result of accounting errors, using the funds for something other than FMS, or the undercharging of foreign customers--or a combination of all three. A high-ranking defense official speculated that it would be at least five years before the accounting problems would be straightened out. [Ref. 3]

B. ISSUES

In May 1979, GAO issued an overview of the problems identified in accounting, billing, and collecting for the FMS program [Ref. 4]. SAAC, created as DOD's single point of contact for foreign countries' FMS financial inquiries, is largely dependent upon the military departments. Each Service is responsible for detailed obligation, expenditure, and cost accounting; for paying contractors; and for reporting disbursements as well as other financial information to SAAC. Each department has developed its own system of accounting. SAAC is dependent upon their inputs, which are nonstandard, to prepare billings, reimburse the departments' appropriations, and account for trust fund expenditures.

After highlighting problem areas, GAO went on to state that although improvements had been made and further improvements might result, DOD had been unable to correct its longstanding FMS financial management and accounting problems. "The Department lacks an adequate program-wide plan to solve the problems. Efforts to correct them have been piecemeal; policy has been established by the ASD (Comptroller) and implemented by the military departments as they saw fit" [Ref. 5]. Long-range planning was lacking.

GAO'S solution to the FMS accounting and financial management problems was centralization. The ASD (Comptroller), because of pressure from the House Appropriations Committee, took heed and, in November 1979, outlined DOD's plan for centralized FMS accounting. Congress had required that the plan include accounting for obligations, expenditures, and disbursements of funds, and that it should ensure that all costs properly chargeable to the program were fully recovered. Only transactions involving direct-cite procurements were to be considered. A six- to twelve-month test wherein the obligation accounting and disbursing for several large FMS contracts from each military department was to take place at SAAC. This test was to provide a basis for evaluation of the advantages and disadvantages of centralization and the degree of centralization yielding the greatest benefit for the investment of resources. [Ref. 6]

C. OBJECTIVES AND SCOPE OF STUDY

The principal objective of the research was to analyze and evaluate the centralized test performed at the Security Assistance Accounting Center. This included a critical look at the validity of the centralized accounting concept itself. The relevance of SAAC's findings in both the support of centralization and the fulfillment of full-cost recovery requirements were tantamount.

This thesis does not address the political question of whether the United States should or should not be an exporter of military equipments and services. Neither are the costs and benefits of FMS and their effect upon the military sevices and the U.S. economy discussed. It is assumed that FMS will continue to be a major element of United States foreign policy, and the management, financial control, and accounting for FMS by DOD will take on increased importance in the future.

Primarily, the research for this thesis was directed towards reviewing the centralized FMS accounting concept and the conduct of test and evaluation procedures, and results, at the Security Assistance Accounting Center. The establishment of the U.S. foreign military sales at-cost requirement and a review of the existing FMS financial and accounting problems recently experienced by DOD were considered to be basic building blocks of the thesis.

D. RESEARCH METHODOLOGY

Data for the thesis was gained from personal interviews with personnel from the Security Assistance Accounting Center (SAAC); review of internal memoranda, point papers, and applicable instructions; review of audit reports; research reports and theses written on FMS, especially in the areas of financial management and accounting; and instructional information gleaned from Professor W. H. Cullin's course, "Foreign Military Sales (FMS) Management."

E. ORGANIZATION

The reader should have a basic knowledge of the development of FMS in order to understand the complexities and problems of the program and how they came about. Accordingly, a brief history is outlined and discussed in Chapter II.

Chapter III continues the overview with a synopsis of applicable restrictions and requirements legislated by public law. The Arms Export Control Act (AECA) is of particular importance in this area in that it established the basis for the U.S. foreign military sales at-cost accounting policy. Specific requirements for billing foreign customers, transfer of obligation and expenditure authority, and methods of financing FMS cases are discussed. Chapter IV elicits several major financial management and accounting problems experienced recently by DOD. It was the long history of these inadequacies that led GAO to pronounce centralized accounting as the long-range solution.

Chapter V examines the centralization concept itself, as proposed by the General Accounting Office. The advantages and disadvantages of central accounting and control, versus a program of separate systems by each military service, are addressed.

Chapters VI and VII review the development and status of DOD's centralization test taking place at SAAC. The test results are examined for relevancy towards the decision of whether or not to expand and implement centralization.

Chapter VIII looks at the current status of the on-going test and the likelihood of implementation. The complete resolution of all significant problems presently confronting the FMS accounting system, by expanding centralization, at least in the short term, is questioned. It is speculated that centralization is, however, the long-range hope for financial control of the program.

In summary, the research basically examines DOD's problems and responsibilities in managing the FMS accounting system. Centralization, as the solution, and its test being conducted at SAAC, are critically reviewed.

II. BACKGROUND OF FMS

> Foreign policy must start with security. A nation's survival is at its first and ultimate responsibility; it cannot be compromised or put to risk. There can be no security for us or for others unless the strength of the free countries is in balance with that of potential adversaries and no stability in power relationships is conceivable without America's active participation in world affairs. [Ref. 7]

A. HISTORY

A primary means used to implement foreign and national security policy has been and remains through the transfer of defense articles, services, training, and economic assistance; or, stated another way, by providing security assistance. America's policy since World War II has been to provide this military assistance to friendly foreign nations. Security assistance can exist in two different forms--grant aid and military export sales. There are two types of grant aid: the military Assistance Program (MAP) and International Military Education and Training (IMET). The MAP, which began under the Military Defense Assistance Act of 1949, was designed to provide for the security of the U.S. by furnishing equipment and services to allied and friendly nations. These were furnished at no cost--a "free" or "give away" program. IMET was established to assist in developing needed expertise and fostering an indigenous training capacity within each of the foreign countries involved.

Military export sales are either commercial, direct procurements by a foreign country from U.S. private sources, or FMS, sales by the U.S. Government to a foreign government.

The legislative basis for FMS is the Foreign Assistance Act of 1961 (PL 87-195), as amended. In 1976, the name of the Act was changed to the International Security Assistance and Arms Export Control Act of 1976 (PL 94-329). It authorizes the President to procure and sell defense services to eligible foreign countries or international organizations. It also authorizes the sales of defense articles from DOD stocks. The Act charges the Secretary of State with the overall responsibility for supervision and direction of sales, including whether or not there will be a sale to a country and the sale's amount. Procurement authority is delegated to the Secretary of Defense. Within DOD, the Assistant Secretary of Defense, International Security Affairs (ASD (ISA)), formulates policy and guidance on matters pertaining to security assistance. The Defense Security Assistance Agency (DSAA) directs and supervises the administration and implementation of that policy and guidance. [Ref. 8]

B. GROWTH OF FMS

At the inception of the Security Assistance Program (SAP) in 1949, and for considerable time thereafter, most military assistance provided by the U.S. was grant aid. The Mutual Security Act of 1951 formalized the foreign aid procedures

under which grant aid was made. The U.S. had provided $29.9 billion through MAP until 1961, while only 2.5 billion in materiel and services had been sold during the same time frame. [Ref. 9]

Several factors led to the reversal of roles played by grant aid and military export sales. Toward the end of the 1950's, the United States' military surpluses of World War II were depleted. An unfavorable balance of payments trend was also being established. These, in addition to the economic progress made by our allies, allowing them to purchase weapon systems directly, or through credits, were causal of the role reversal. Each year since 1974, FMS have exceeded grant aid, and today FMS comprises approximately 90 percent of the U.S. security assistance program. [Ref. 10]

C. CREATION OF THE SAAC

Prior to October 1976, each of the military departments acted independently in the conduct of its FMS program. Each Service was responsible for procuring, accounting, disbursing, billing, and collecting funds for FMS cases from foreign customers. With the sharp increase in the FMS program since 1974, DOD's financial management system was not capable nor designed to handle the tremendous growth. Because of the time pressures and rapid expansion of the program, DOD had to add foreign military sales accounting requirements to the existing financial management systems, instead of designing and implementing separate financial systems for FMS.

Several GAO reports criticized DOD for subsidizing the FMS program with U.S. funds since the cost of the program could not be readily identified. This was a result of the inability of the DOD financial systems to collect pertinent costs such as administrative, transportation, packaging and handling, military and civilian salaries plus fringe benefits, and R&D costs, applicable to a unique FMS case. Additionally, foreign countries began to complain about the numerous billings received from each of the military services and questioned why they could not receive single billings.

In an attempt to resolve some of these criticisms, DOD began to centralize the FMS management. One of the significant steps taken was the creation of a central billing and collection agency in the Security Assistance Accounting Center (SAAC).

The SAAC was established in 1976 by the Secretary of Defense as the central DOD activity for carrying out certain responsibilities under the Foreign Assistance Act of 1961 and the Arms Export Control Act. As the executive for DOD under the Defense Security Assistance Agency (DSAA), it was singularly responsible for the billing, collecting, and trust fund accounting system for security assistance. SAAC simultaneously served as the central point of contact within DOD for all FMS-related financial inquiries, and as a focal point for DOD-wide procedural and operational financial systems.

Within these responsibilities, SAAC also was responsible as the primary data base for reporting FMS program status to

Congress, the National Security Council, Office of Management and Budget (OMB), and other executive agencies. The SAAC was collocated with the Air Force Accounting and Finance Center (AFAFC) in Denver, Colorado and placed under the direction of the director of AFAFC, who was also appointed as the Assistant Director, DSAA. The first centralized billing was achieved in May 1977, when the SAAC released a billing statement to all FMS customers. It was 66,400 pages long and requested customer payments of $2.1 billion. [Ref. 11]

III. ACCOUNTING FOR FMS

> You may recall that GAO has beat us severely about the head and shoulders for not recovering all the quality assurance costs in the manner prescribed in DOD Instruction 2140.1. Notwithstanding our serious objections to the shortcomings and overstatements in the GAO findings, the House Appropriations Committee went ahead and reduced the Services' FY 1980 O&M budgets by the amounts that GAO alleged were lost. [Ref. 12]

A. REQUIREMENTS

The Arms Export Control Act (AECA) provides the legal basis for FMS accounting policies and procedures. DOD Instruction 2140.3 and the Military Assistance and Sales Manual (MASM) supply amplifying information. The following requirements warrant special emphasis.

1. "No profit/no loss" to the U.S. Government

The U.S. Government, in procuring the furnishing the materiel and services requested by a foreign government, does so on a nonprofit basis for the benefit of the foreign purchaser. The foreign customer agrees to pay the U.S. Government the total costs incurred regardless of the sales terms negotiated at the time of the acceptance of the offer. The U.S. Government is only obligated to notify the foreign government if the expected cost of the sale is to increase above ten percent of the original estimate.

Each FMS "case," or contractual sales agreement between the United States and an eligible foreign country or

international organization, is documented by a Letter of Offer and Acceptance (LOA), also known as DD Form 1513. The LOA is the formal document by which the U.S. Government offers, and the foreign government accepts, the sale of specific defense articles and services. It stipulates the items and/or services, estimated costs, and the terms and conditions of sale. The LOA also specifies an expiration date, which is developed through the consideration of several factors such as: the contractor price quote expiration date, normal processing time, and sensitivity of any information in the LOA.

2. Advance Collection of FMS Costs

The purchaser, unless the DD Form 1513 specifies otherwise, must agree to the U.S. Government policy of collecting the foreign country's funds in advance of deliveries or progress payments to contractors. These advance collections are subsequently available for progress payments, contractor holdbacks, potential termination charges, and deliveries from DOD inventories. The LOA Financial Annex (Payment Schedule) specifies the down payment and schedule of payments to be followed. The AECA also states that the total funds on deposit should be sufficient to meet the payments required by the contract and any damages and cost that may occur from the cancellation of such contract in advance of the time such payments, damages, or costs are due. The funds are kept on deposit with the U.S. Treasury.

3. Collection of Interest on Delinquent Accounts

The foreign country must agree to pay interest on any net amount which it is in arrears on payments, as determined by considering collectively all of the country's open LOA's within DOD.

4. Standardized Billing Procedures

It is DOD policy that the form, content, cycle, basis, and adjustment of FMS billing to foreign countries and international organizations be standardized. This is a responsibility of the SAAC.

B. PRICING

The systems of controls, pricing quidelines, and reporting systems of FMS evolved from MAP. During the 1960's and early 1970's there was little emphasis placed on what now is called "full cost recovery", since management emphasis tended to be placed on the security assistance aspect of the program, rather than on the sales act per se. [Ref. 13] Today, with the passage of the AECA in 1976, there is a greater emphasis on the recovery of all costs in DOD pricing.

The Department of Defense follows a policy of uniform application of pricing and cost criteria in FMS management. This means that DOD pricing and procedures provide for the charging of all DOD direct and indirect costs, including those referred to as an "administrative charge" for the use of DOD's logistics system. In order to assure that all costs are covered, quotations on defense articles and services are

estimated and final adjustments are made after delivery of the items or rendering of the services. The DD Form 1513 provides for these estimated prices.

Pricing defense articles and services can be divided into two areas--those from DOD stocks and those which are newly procured. Items from stock inventories are handled in accordance with DOD Instruction 2140.1. Standard prices govern when nonexcess materiel is to be sold. This includes all items in the U.S. military supply system, except major items, like complete ships. Standard prices include current market or procurement costs, and they are generally revised annually. If materiel is in long supply, or if the inventory manager determines there is a difference in utility, standard prices may be reduced. Excess materiel is sold in an "as is" condition. The selling price is the higher of (a) its market value as military hardware, or (b) fair value computed by applying a fair value rate to inventory price. Prices of defense articles and services procured for foreign governments must include recovery of the full DOD contract costs (including the cost of government materiel). In addition, the purchaser must pay any damages or costs that accrue from the purchaser's cancellation of the contract. Authorized surcharges are added to the contract cost and included in the billing.

Prices of defense articles and services sold to eligible foreign governments and international organizations may include the following charges:

1. Accessorial costs--for expenses of issuing and transferring materiel (if applicable). This is similar to a materiel handling charge and is generally added as a percentage factor.

2. Administrative Charge--for expenses of sales negotiation, procurement, accounting, budgeting, etc. In accordance with DOD Instruction 2140.1, a charge of five percent is normally added to the basic sales price of FMS orders. DSAA is authorized to reduce this charge to three percent on sales of nonstandard articles (those not actively managed because associated end items have been retired or never purchased for DOD components). The administrative charge is applicable to all transactions.

3. Nonrecurring Cost Recovery--for DOD investment in RDT&E and production costs (if applicable). These are assessed on a pro rata basis. In other words, the FMS customer is charged a per unit amount determined by dividing total nonrecurring costs by the total production quantity (past production plus estimated future production).

4. Asset Use--for use if DOD facilities and equipment (if applicable); these are added as a percentage factor.

5. Recurring Support Costs--costs that are directly related to FMS delivery from a production contract.

C. FMS TRUST FUND

The FMS trust fund is a fund managed by the Treasury in which FMS monies from foreign governments are held in trust,

or in a fiduciary capacity, by the U.S. Government for use in making purchases specified in an LOA. The SAAC has accounting responsibility for the trust fund even though the funds are on deposit with the Treasury. The FMS trust fund represents the sum total of all cash received from all foreign countries and held by the Treasury for FMS purchases. Receipts and disbursements are accounted for at the country level regardless of what case they are made for. Individual case accounting records are maintained by SAAC.

The following principles apply to trust fund management:

1. One foreign country's balance cannot be used to finance another foreign country's programs.

2. Cash disbursements are controlled on a country basis, although accounting for FMS transactions is on an FMS case level basis.

3. With the purchaser's permission, cash receipts in the trust fund can be shifted within a country's program (between cases). The accounting status of each individual case is still maintained by SAAC, however.

4. Dollars received into the FMS trust fund increase the overall volume of funds within the United States Treasury. The dollars become part of the overall U.S. Treasury accounting system, and are therefore under U.S. Government control from date of receipt. SAAC, as the accountable agency, renders periodic reports to the Treasury. [Ref. 14]

D. FINANCIAL ADMINISTRATION AND CONTROL

Two forms are prescribed for use by the military services in accounting for FMS funds: DD Form 2060 (FMS Obligational Authority) and DD Form 2061 (FMS Planning Directive).

1. DD Form 2060

This form is prepared by the cognizant Service or implementing agency. It is used to request obligational authority from SAAC.

2. DD Form 2061

This form is the "detailed back-up" document for the DD Form 2060. It shows detailed pricing elements, planned financing appropriations (or direct citation), obligational authority received and required at a date specified, obligational authority required for the current year, and an estimate of obligational authority required for the budget year.

DD Forms 2060 and 2061 are required to be prepared for each new FMS case at the time the LOA is prepared and prior to its acceptance by the foreign government. In addition, a copy of each DD Form 2060 must be submitted to SAAC prior to the issuance of obligational authority. [Ref.15]

Further, DD Forms 2060 are required to be submitted before the beginning of each fiscal year reflecting the funding status through 30 September of all active FMS cases and identifying the amount required for obligation for the

current year. With this information, SAAC is able to forecast expenditures reliably, assuming expenditures will approximate the obligational authority approved for the year. SAAC can also ensure that country balances in the trust fund are sufficient to cover all costs to be incurred in the near term as required by the AECA.

The SAAC can control FMS funds through two processes--the issuance of obligational authority and the issuance of expenditure authority. These two processes are exclusive of each other.

1. Obligational authority (OA) is an authority requested by a military service or DOD agency from SAAC (DD Form 2060) which allows obligations (legal reservations of funds) to be incurred within a given FMS case in an amount not to exceed the value of the OA granted.

2. Expenditure Authority (EA) is granted by SAAC to a military service or DOD agency to allow expenditures (actual payments) to be incurred against obligations previously recorded against a country's trust fund account.

E. FINANCING AND FLOW OF FUNDS

There are primary methods of financing FMS transactions. [Ref. 16]

1. Direct Citation Method

This method involves entering and perpetuating the FMS trust fund accounting citation on all documents. With direct citation, expenditures are made directly from the

trust fund account by military disbursing offices. In accordance with DOD Instruction 2140.1, new procurement actions should be accomplished by this method if possible. This is to prevent, as much as possible, subsidy of FMS procurements with U.S. appropriations. SAAC issues monthly country-level expenditure authorizations (EA) to Services utilizing the direct citation method. This EA is applicable to new procurement expenditures (e.g., progress payments), and inventory issues from DOD stock (when an interfund billing is made).

2. Reimbursable Method

Under this method, expenditures are made against U.S. appropriations, which are either supported by a cash advance from the FMS trust fund or subsequently reimbursed. The SAAC handles the accounting for funds transfers regarding all reimbursables. Self-reimbursement expenditure authorization (EA) may be issued by the SAAC--"Status of Self-Reimbursement Expenditure Authority" (DD-COMP(M) 1518). These summary reports are supported by further details required by the SAAC within ten days after the end of each month--"FMS Detail Delivery Report" (DD-COMP(M) 1517). The DD-COMP(M)1517 detail cards are also used by implementing DOD components in support of requests for cash advances to appropriation accounts. When the reimbursable method is used, there is always the possibility that U.S. appropriations will not be reimbursed for the full cost of the FMS case procured under it.

In fact, the GAO has issued numerous reports revealing where the DOD has subsidized FMS through U.S. appropriations.

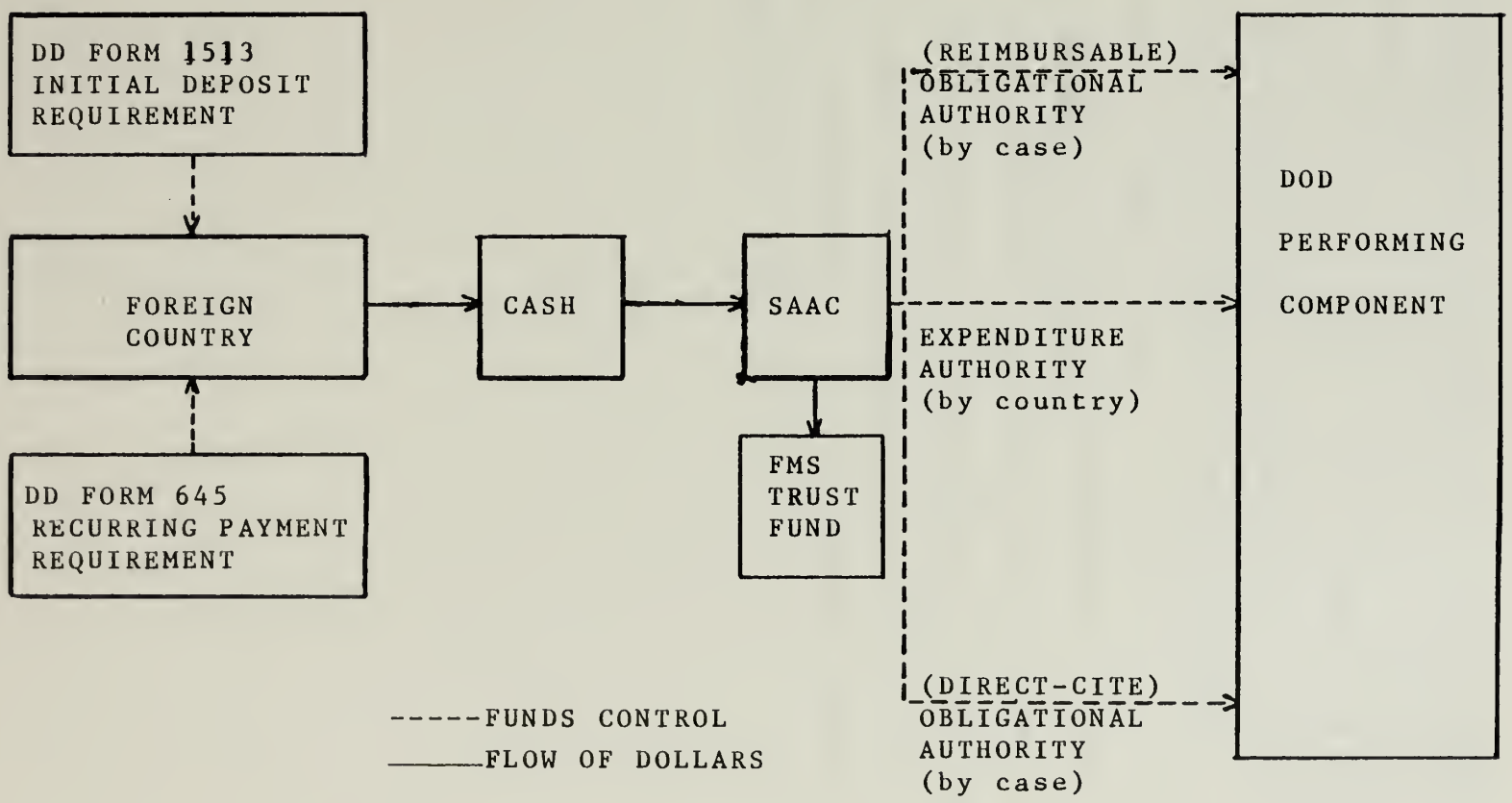
Figure 1 represents the flow of funds for FMS. The process begins with U.S. Government demands placed on the foreign purchaser for funds. These are generally in one of two forms: (a) the initial deposit (if applicable), reflected in the LOA and, (b) the recurring payment requirements which are contained in the DD Form 645 (Quarterly FMS Billing Statement). Cash received from foreign countries, always in U.S. dollars, is deposited into the trust fund account by the SAAC. The SAAC controls the administration of the funds through the issuance of obligational authority and expenditure authority.

F. BILLINGS TO FOREIGN GOVERNMENTS

The FMS Billing Statement (DD Form 645) is used in billing foreign governments. The statements are prepared and forwarded by SAAC to the FMS purchaser on a quarterly basis (i.e., for quarters ending March, June, September, and December). The DD Form 645 represents the official claim for payment by the U.S. Government and furnishes an accounting to the FMS purchaser of all costs incurred on its behalf for each FMS case. The terms of sale of each case dictate the timing, amounts, and due date for payments against these billings, on time and in full, by the terms of sale. Interest, at a rate determined by the Secretary of the Treasury, is chargeable on any net amount due and payable which is not paid within sixty days of the billing.

FIGURE 1

FLOW OF FUNDS FOR FMS



Prepared by Author

This period may be extended by the President to one hundred and twenty days (only upon his submission of this determination to Congress).

The correctness of a FMS billing is largely dependent upon the military services. The timeliness and accuracy of their input to the SAAC is tantamount. The implementing DOD components report performance and execution to the SAAC by use of the DD-COMP(M) 1517 (FMS Detail Delivery Report). The report is made on magnetic tape or punched card and is submitted on a monthly basis. Expenditures, progress payments, and delivery information is reported in this manner. Inaccurate data or delays in submission can result, among other problems, in under-or-over-payments by purchasers and under-or-overreimbursement of the performing accounts of the military departments. [Ref. 17]

IV. FMS PROBLEMS DISCLOSED

Defense could not fully explain differences of $1.5 billion between its official trust fund accounting records showing cash on hand and the detailed records used to provide foreign governments an accounting of how their funds were spent. Defense problems in accounting and reportng foreign military sales disbursements and collections were disclosed in 1976 when the Services transferred responsibility for maintaining detailed sales case accounting records to the Security Assistance Accounting Center. Since then, the differences have increased. [Ref. 18]

A. FMS POLICY IMPLEMENTATION

On June 17, 1977, the Assistant Secretary of Defense (Comptroller) directed that a new FMS financial reporting system be adopted. When fully implemented, it was to: (1) provide an integrated accounting and financial control system, (2) provide accounting support for the budget, (3) facilitate budgeting, financial planning and cost estimating, and (4) ensure compliance with all requirements for the administrative control of funds and provide a trust fund accounting system that would meet GAO standards. The system was not intended to provide for detailed obligation, expenditure, and cost accounting or for disbursing foreign customer funds or for billing and collecting. These functions would continue to be carried out by the military departments and the SAAC. [Ref. 19]

In response to the Assistant Secretary's memorandum, and because SAAC's billing, collecting, and trust fund system did not provide the necessary financial accounting and control, the Center began developing the Defense Integrated Financial System (DIFS) in November 1977. This system, designed to cover various facets of FMS financial management--particularly billing, collecting, and trust fund accounting--remains dependent upon input from the military departments.

It has now been almost three years since system implementation was mandated, and full implementation has not occurred. Actions by the Services to comply have varied. In addition to SAAC's DIFS, the Army developed a new obligational control system. It has had a history of errors, frequently documented by the Army Audit Agency. The Air Force attempted without success, to adapt its existing system in order to implement the memorandum. The Navy modified its existing system. Uniform accounting and financial reporting has not been attained. Nonstandard accounting data is currently received by the SAAC, necessitating numerous modifications, and frequently contributing to accounting errors.

B. COST RECOVERY IN FMS

With the enactment of the AECA, Congress attempted to strengthen and clarify FMS cost recovery requirements as a matter of law. Its legislative history indicates that Congress intended that indirect as well as direct costs of

goods and services sold to foreign governments be recovered so that the FMS program would not be subsidized by DOD appropriations [Ref. 20]. There has been some disagreement, however, as to which elements of cost, particularly indirect costs, constitute the "full cost" of a sale. Developing complete and understandable FMS pricing guidance, for example, has proven to be no small undertaking. DOD has focused a considerable amount of attention on improving its pricing policies and cost recovery criteria, with GAO acting, in many instances, to prod their action. Improved policy guidance has led to increased FMS cost recoupment. Recoupment, however, still remains well below where it should be if the FMS program is to operate at no loss to the Government. [Ref. 21]

The Foreign Military Sales Program is being subsidized by DOD in that the cost of quality assurance services performed by the Defense Contract Administration Services Regions (DCASR's) is not being recovered from foreign governments. GAO estimated that up to $370 million had not been recovered from fiscal 1973 through 1978. Most of this amount was not recovered because Defense lacks a workable system through which the DCASRs can find out which items are being procured for FMS. Without adequate identification, quality assurance inspectors are not able to provide the Regions the necessary data for billings to foreign customers for the inspection services. The Services do not have a standard system for

writing prime contracts that easily identify FMS items. Therefore, the only way that DCASRs are able to determine the amount of foreign sales is through detailed review and analysis of contracts. GAO feels that the DCASRs do not have enough qualified personnel to properly perform these evaluations. [Ref. 22]

DOD is not charging foreign customers the replacement cost of items sold from inventories, although required to do so by law. Replacement costs are now generally much higher than the prices charged. A recent GAO report focused attention on sales from secondary equipment (i.e., not major and complete systems) and spare parts inventories [Ref. 23]. These items are generally categorized as stock fund or nonstock fund material. Stock funds are self-sustaining revolving funds financed by sales to appropriated activities. Nonstock fund items are purchased with direct appropriations and are furnished without reimbursement. The magnitude of secondary item sales is appreciable--28 percent of total FMS in fiscal year 1976.

Defense Directive 7420.1 governs stock fund operations, including pricing policies. It requires that each stock-funded item must have a standard price for inventory accounting and sales reimbursements. The standard price includes three factors: procurement cost, transportation cost, and a surcharge to offset operating losses. However, standard prices, when based on historical costs, are not

sufficient to recover replacement costs during periods of inflation. In an effort to remedy this situation, in fiscal year 1976 the Secretary of Defense implemented a plan referred to as the stock fund stabilization pricing policy. Under the plan, prices included a surcharge which is recomputed annually. GAO charges that, although the new pricing policy does prevent depletion of the stock fund, it does not generate sufficient funds to fully recover replacement cost as required by the AECA.

For nonstock fund sales to foreign governments, military departments were allowed to develop their own pricing policies and procedures. The methods used varied and resulted in inconsistent and inadequate pricing. As a result, not all replacement costs were recovered. Army regulations required nonstock fund inventory items to be priced at the higher of standard or replacement costs (if replacement costs exceeded standard costs by five percent). This was interpreted differently by separate commands, however. One command decided that all nonstock fund items would be replace and determined that a 19.86-percent factor should be added to the standard price of items sold to foreign governments. Another command decided to determine, on an item-by-item basis, which items were to be replaced. Prices for these items were increased by using inflation indexes. The revised prices became the billing prices to the foreign governments. The Air Force decided to manually determine prices for FMS

nonstock fund items. Standard prices were corrected by an adjusted final billing. This process did not always work because of the multitude of transactions involved and the frequent use of erroneous pricing data. The Navy had no system to ensure that replacement costs were charged to foreign governments for nonstock fund items. The latest revision to Defense's pricing policy, DOD Instruction 2140.1, provides that all non-excess secondary items sold from Defense inventories to foreign governments must be replaced and requires that inflation factors be added to the inventory price. Each year a new inflation factor is calculated and replaces the prior year's factor. GAO reports that, although the use of rates or factors is the most practicable means of establishing the replacement cost, DOD's method does not provide for the recovery of the replacement cost in those cases where secondary items are purchased prior to the year in which they are sold. For example, assuming an average annual inflation rate of 7 percent, an item last purchased in 1975, sold in 1978, and replaced in 1979, would cost 28 percent more to replace than its inventory price (4 years at 7 percent a year). However, under Defense's methodology only a 7-percent inflation factor would be added to the inventory price since prior year inflation factors would be eliminated. Thus, the item would be sold at the 1975 price plus 7 percent, which would not provide for the replacement of the item. Inflation or replacement must be compounded where items were

last purchased during earlier fiscal years. GAO maintains that Defense's decentralized approach to pricing has not worked. [Ref. 24]

C. FMS TRUST FUND DIFFERENCES

The General Accounting Office disclosed that DOD's FMS detailed accounting records differed by $1.5 billion from trust fund records showing cash on hand for September 30, 1979 [Ref. 25]. Defense could not fully explain this difference. DOD departments and agencies make payments for FMS cases and directly charge the cash account at the Treasury. Monthly, they are required to send the SAAC a breakdown of total expenditures by country. They must also provide the SAAC with detailed expenditure reports for use in posting detailed sales case accounting records. Thus, foreign trust fund balances kept by DOD are recorded in two records at the SAAC: (1) trust fund accounts in which all collections and disbursements of each customer are tracked, and (2) detailed sales case accounting records indicating which sales agreement are affected. These records should agree, and, unless they do, DOD cannot give foreign customers a proper accounting for their funds nor control the monies available for FMS purchases. The sales case accounting records are used to prepare FMS billings; they should accurately reflect all receipts, disbursements, and cash on hand.

Some of the differences between the accounting records have been explained. Processing delays prevent the detailed sales case records from being as up to date as the trust fund records. Each department, for a variety of reasons, encounters delays in reporting detailed transactions. Another cause cited for differences is the existence of system deficiencies, referring primarily to the handling of inter-country transfers. Agreements whereby a sales to one country is financed by another causes problems. The SAAC has recorded the intercountry transfers in the trust funds, but failed to make corresponding entries in sales case records. Entries were not made because the cases could not be identified. Data processing frequently causes errors also. Expenditure data may be rejected when it does not meet the SAAC's edit criteria. Voluminous rejections have led to a sizable time lag. Further, differences have been perpetuated over time. Trust account balances result from collections and disbursements dating from the inception of the FMS program. However, sales case records are maintained only for active cases. When cases are closed, the cash balance, if any, is either returned to the customer or transferred to remaining active cases. The handling of cash balances would not cause differences if records were properly closed and entries to trust fund accounts were made accurately. Past errors have occurred, however, and they may never come to light, as many records are incomplete or have been lost. [Ref. 26]

The Department of Defense has recognized that action must be taken to improve the accuracy of the FMS accounting and financial management system. Each military department, along with the SAAC, however, has developed its own accounting system for foreign military sales. They have not provided accurate nor timely data, and DOD is unable to render foreign customers a proper accounting of their funds. As an example of continuing-type difficulties, the following is an excerpt from a recent GAO report:

> In September 1979, the Assistant Secretary of Defense (Comptroller) issued instructions requiring the military departments to provide detailed foreign military sales reconciliation data to the Center. Specifically, the departments are required to provide the Center a monthly report of reconciliation between the value of expenditures charged to the trust fund and individual disbursements charged to specific sales cases.
>
> Each military department has reacted differently to the requirement. The Army is currently unable to meet the requirement without certain accounting system modifications. Army officials advised us that it would take up to 18 months before such capability could be implemented. The Navy, although able to meet the requirement, is seeking a waiver of the requirement to list individual reconciliation items. Air Force officials advised us that they are satisfied with the recnciliation requirements but will seek changes to other aspects of the Assistant Secretary's instruction. [Ref. 27]

D. OTHER PROBLEMS

1. Expenditure Projections

Many echelons within DOD are involved in developing expenditure projections in the FMS field. As a result, projections have been poor, and Defense's ability to ensure compliance with provisions of the AECA has been limited.

The act requires that adequate foreign customer funds be on deposit in the trust fund in advance of an expenditure being made. Expenditure projections must also be precise because of the impact on the budgeting systems of the various foreign governments involved.

2. FMS Delivery and Performance Reporting

Shipments of articles, and services provided, to foreign nations by Defense contractors are not promptly reported to the SAAC. The status of orders reported to foreign customers is, therefore, inaccurate and creates customer dissatisfaction. As an example of many, the Army completed delivery of 111 wreckers valued at $8.9 million to Iran in 1977, but two years later it still had not reported this information to the Center.

3. Progress Payments

Defense does not have accounting systems which are able to accurately assign to sales agreements those progress payments made to contractors for a foreign government. In lieu of making an accurate accounting, the systems arbitrarily allocate the payments to Defense appropriations' and foreign customer's accounts. Therefore, they are unable to assure that the correct country's trust fund has been charged for the items and services produced and delivered. [Ref. 28]

4. Personnel Problems

The military departments and the SAAC are severely restricted in their ability to respond to new foreign

military sales policies because the number of experienced professional financial management personnel is limited. Problems also exist at the Secretary of Defense level. For example, only two accountants were found by GAO to be assigned for the preparation and updating of FMS policies in the areas of billing, collecting, pricing, and accounting [Ref. 29]. Funding for additional personnel should not be a problem for Defense, since the AECA requires foreign governments to provide reimbursement for the cost of administering the FMS program. The cost of additional personnel needed to administer the program should be covered by reimbursements. However, military and civilian personnel ceilings do exist, having been imposed on DOD by Congress, and restrict the hiring of additional administrative personnel.

V. CENTRALIZATION CONCEPT

> The degree of centralization of organizations is an indication of what the organization assumes about its members: high centralization implies an assumption that the members need tight control, of whatever form; low formalization suggests that the members can govern themselves. [Ref. 30]

A. GAO SOLUTION

The General Accounting Office (GAO) believes that the best and most expeditious way for Defense to resolve its foreign military sales financial management and accounting problems is to establish a centralized accounting and disbursing organization. Foreign military sales are unique in that funds of other countries are involved. The United States has fiduciary responsibility that goes beyond normal Government appropriation and expenditure accounting. By the terms of the Arms Export Control Act, the cost of the program must be assessed foreign governments, and therefore, good accounting, costing, and financial management systems are required. The General Accounting Office has frequently criticized the Department of Defense for its inability to properly manage the finances of the foreign sales program. Serious problems still exist, and GAO believes that they will continue unless a comprehensive centralized accounting and financial management system is developed solely for foreign military sales. GAO has stated that, although other

alternatives exist, the best long-term solution is a central organization responsible for obligation and expenditure accounting and disbursing of funds, and assuring that all costs properly chargeable to the program are recovered. [Ref. 31]

B. ADVANTAGES AND DISADVANTAGES

Centralization of FMS accounting and financial management is expected to have several advantages. Major advantages include:

--Uniform Accounting and Financial Reporting

Each of the military departments has a different accounting system for FMS. Uniform accounting will eliminate the reporting of nonstandard accounting data and provide greater accounting control.

--Direct Cite Accounting

Reimbursable accounting requires adjustments and transfers of funds between appropriations. There is always the possibility that U.S. appropriations will not be fully reimbursed, creating an illegal subsidy of foreign sales. Direct citation accounting eliminates this possibility.

--Control Over Disbursements

Direct control over FMS disbursements will reduce reconciliation requirements between trust fund accounts and detailed sales case accounting records.

--Improved Accounting

Better accounting will better enable Defense to meet its fiduciary responsibility to foreign customers.

--Expenditure Projections

More precise expenditure projections will be possible because of the elimination of some of the echelons currently involved in their development.

--Planning

Better programwide (DOD FMS) planning is envisioned since accounting and financial management will no longer be fragmented

As with most new systems, centralization of FMS accounting and financial management is also expected to elicit some problems. These disadvantages include:

--Conversion

New precedures will necessitate changes. Initially, dual systems will be required.

--Personnel

Numerous qualified personnel will be required. Funding will not be a problem, since the AECA requires foreign governments to reimburse the cost of FMS administration; however, military and civilian personnel ceilings do exist.

C. SUBSEQUENT ACTION

As a result of GAO's criticism and recommendation, the Department of Defense decided to conduct a test of the Application of centralization to the FMS program. The remainder of this thesis addresses the development and evaluation of the test.

VI. CENTRALIZATION TEST--DEVELOPMENT

> Centralization could take several years. It should be carefully planned, and any new system should be thoroughly tested and proven before implementation. In this regard, the steering group charged with identifying and ranking according to priority foreign military sales financial management problems should be strengthened so that it is able to monitor the implementation of any new or improved systems. [Ref. 32]

A. INCEPTION

1. GAO Recommendations

In March 1979, the General Accounting Office released a report assailing DOD's FMS pricing policies--saying that by failing to properly implement these policies, DOD was effectively allowing U.S. appropriations to subsidize foreign military sales. GAO recommended that Defense assign specific responsibility for implementing FMS pricing policies to a new or existing organization that could be freed from other work to properly monitor the implementation. [Ref. 33]

In May of the same year, after a general review of FMS problems, GAO recommended that DOD produce a plan for centralizing accounting and financial management. It specified that the plan should include obligation and expenditure accounting and disbursing of funds, and should assure that all costs properly chargeable to the program were fully recovered. Specifically, the plan was to (1) specify the responsibilities of the central accounting organization,

(2) identify the support required from organizations involved in the FMS program, including personnel needs and descriptions of duties, (3) establish detailed policies and procedures, (4) define systems requirements, (5) establish milestones for development, testing, and implementation, including the transfer of existing personnel positions to the centralized accounting organization, and (6) require that the new system be developed and designed in accordance with the Comptroller General's accounting principles and standards and submitted to him for formal approval. [Ref. 34]

The General Accounting Office felt that together, these recommendations would, in the long term, be the best alternative for solving the accounting and financial management problems plaguing the foreign military sales program.

2. Congressional Direction

The House of Representatives Committee on Appropriations, on September 1979, agreed with GAO's recommendation on the need for centralization of FMS accounting. [Ref. 35] The Committee reviewed the existing problems, and highlighted their agreement by illustrating what happened when Iran cancelled its FMS orders:

> DOD could not go to one source and determine with any degree of accuracy what the cash balance for this account was. It became necessary for each military department to designate special management teams to visit various commands and accounting activities in an attempt to understand the financial situation. As late as March 1979, it was estimated the $1 billion in deliveries had

> been made to Iran but not reported to the SAAC.....In addition, about $250 million in U.S. Army and U.S. Air Force direct-cite progress payments have been made on behalf of Iran but not identified at the FMS case level to the SAAC. [Ref. 36]

The Department of Defense was directed to produce a plan for centralized accounting and financial management. The plan was required to include obligations and expenditure accounting and disbursing of funds. FMS accounting was to be separated from accounting for Defense's own operations to the maximum extent practicable. Because of the seriousness of the problems in terms of the amounts involved, and the need to properly account for the foreign funds, the Committee set a March 1980 deadline for the submission of the plan.

3. Defense Response

In November 1979, the Assistant Secretary of Defense (Comptroller) (ASD(C)) declared that Defense would conduct a six- to twelve-month test, beginning February 1980, wherein the obligation accounting and disbursing for several large FMS contracts from each Service would be centralized at the SAAC. Only sales transactions involving direct-cite procurements were considered in the plan.

DSAA, in conjunction with the SAAC, was assigned responsibility for the test and was to be the principal point of contact to provide overall test coordination. All Services were directed to participate fully and provide support as required. DSAA was to submit quarterly progress reports on the test results, initially to address the

compilation of a milestone plan, and later to discuss the merits and problems of centralization. The ASD(C) required DSAA to render a final report upon completion of the test, but no later than February 1981. [Ref. 37]

B. INITIAL TEST PLAN

1. Objectives

Project officers from each of the Services and DSAA first met on November 1979 at the SAAC, with the purpose of reviewing the test objectives and discussing implementation. A summarized version of the objectives adopted from this meeting follows:

--Evaluate the feasibility of centralization of accounting and disbursing of direct-cite procurements.

--Verify advantages/disadvantages of centralization.

--Develop DOD accounting and disbursing systems to meet FMS directives.

--Define resource and system development requirements.

--Determine the degree of centralization that will yield the greatest benefit for the resources invested.

--Provide the basis for DOD's report to the Congress. [Ref. 38]

2. Milestones

A second Project Officer's Meeting was held the following month to establish milestones and coordinate the scope and content of the test. As a result of this meeting,

DSAA prepared and submitted a milestone plan to ASD(C). Dated December 31, 1979, a summary of its highlights follows: [Ref. 39]

ACTION	DUE DATE
--Services identify candidate contracts. They should provide a sufficient volume and variety of transactions to expose system complexities, without exceeding capabilities of the test team.	21 Dec 79
--SAAC selection of contracts to be used for the test.	10 Jan 80
--Initiate quarterly status reports to DSAA.	15 Jan 80
--Services identify and define the information required as feedback on transactions for management status reports.	18 Jan 80
--Publish detailed test procedures.	31 Jan 80
--Services provide advance copies of selected contracts to SAAC.	1 Feb 80
--Services audit and amend selected contracts and accomplish all actions necessary for proper transfer of accountability.	15 Feb 80
--Final coordination on test procedures.	15 Feb 80
--Fully audited contract files and accountability transferred to SAAC.	29 Feb 80
--Initiation of test.	1 Mar 80

--ASD(C) report to the Congress. 31 Mar 80

--Develop and implement, with concurrence of the Services, a mechanized system of interface with the automated systems of the Services. 1 Jul 80

--Each of the Services and the test team prepare and submit a final report to DSAA. 14 Nov 80

--DSAA to submit a final draft report to ASD(C) noting advantages and disadvantages of centralization. 15 Jan 81

--ASD(C) report to the Congress, noting test conclusions and recommendations. 31 Jan 81

3. Contract Transfer Process

Procedures were developed to ensure an orderly transfer of responsibility and accountability from each Service to the SAAC. The following actions were taken (in succession) concerning those contracts chosen for the centralization test: [Ref. 40]

--Services provided advance copies of contracts and modifications to the SAAC.

--A disbursement cutoff date was established and contracts were scheduled for audit through the effective transfer date.

--Services requested contractual commitment authority (CCA) from the SAAC in the amount equal to the total value of the obligation authority (OA) and any outstanding commitments reflected in the accounting records for each contract.

--Services modified contracts and unobligated commitment documents to show the new accounting classification and changed the paying station to AFAFC/SAAC.

--Services returned OA to the SAAC by use of the existing DD 2060 process.

--Services transferred accountability for cumulative disbursements to the SAAC. Paid disbursements for each contract were transferred to the FMS Trust Fund Account.

--Services returned expenditure authority (EA) previously received from the SAAC equal to the disbursements being transferred.

--The SAAC Test Team initiated contractual disbursements.

--Services provided the SAAC with a complete financial audit of all obligations, commitments, disbursements, unrecouped progress payments, and deliveries through the transfer date.

4. Operating Procedures

a. Transfer of Authority

For the purposes of the centralization test, all Services were required to return the OA previously received from the SAAC. This applied only to the direct-cite cases/contracts chosen for the test. As a replacement for OA, the Services received CCA. Contractual Commitment Authority (CCA) represented the Procuring Contracting Officer's (PCO's) authority to incur commitments and

obligations, not disbursements however. Expenditure authority was also returned to the SAAC. It was reissued internally as FMS invoices were received for payment.

b. Accountability

To facilitate the test, the SAAC utilized the Air Force base-level B3500/3700 computer maintained by the Accounting and Finance Office (ACF) located at AFAFC. This effectively suballocated authority/responsibility to AFAFC. Although contrary to the requirements of the ASD(C) and DSAA that the SAAC act as the accountable station and disbursing office during the test period, this action did retain the accountability within AFAFC and negated the requirement for additional resources to establish separate accounts control and disbursing functions within the SAAC.

c. Files and Ledgers

The Contract Accounting Division of the SAAC set up three main files on each contract transferred in the test. These included: (1) Contract File--the basic contract along with all supporting documents, (2) Modification File--all contract modifications, and (3) Payment File--all pertinent documents relating to payments. Contract ledgers were established for each contract and subdivided by FMS customer. These were further subdivided by FMS case, and each case by Accounting Classification Reference Number (ACRN). Each ACRN was separated by Contract Line Item Number (CLIN).

Obligations, disbursements, and progress payments were posted at the ACRN level. Quantity data was also maintained at the ACRN level (or CLIN level if there were more than one CLIN per ACRN). [Ref. 41]

d. Performance Reporting

Documents used to support the contractor's work claims are the DD Form 1195 (for work in progress) and the DD Form 250 (for completed work). After invoices were paid by AFAFC/ACF, these forms were returned to the Test Team, where their information was converted to the standard DD Form 1517 (DIFS) input format. After editing, this was processed to a FMS Performance Report and FMS Billing Letter (DD Form 645). Because of the separate and unique accounting/delivery reporting methodology used by the Services, it was necessary to separate payment documents by military service, and then by country and case. The DD Form 1517 was prepared differently for each Service to report progress payments and deliveries.

e. Management Feedback Reporting

Given that each Service had its own unique reporting requirements, a standardized approach to reporting was not envisioned. Each Service requirement was dealt with on an individual basis.

(1) Army. Due to the Army's extensive use of Appropriation Reimbursable Funding for FMS procurements, a ready vehicle for the reporting of direct-cite disbursements

did not exist in a standard format. Workable report formats were developed. Hard-copy distribution was set up utilizing postal channels.

(2) Air Force. The Air Force elected to receive feedback data in the form of a Contract Payment Notice (CPN) that conforms to MILSCAP specifications (DOD Instruction 4105.63-M). The autodin network was utilized for data transmission. Additional reports were made using a postal distribution.

(3) Navy. The Navy elected to receive hard-copy feedback, in lieu of a card-tape update to their system. Their report was distributed to project officers through postal channels. [Ref. 42]

f. Contract Involvement

Initially, the test involved sixteen contracts (eight Army, five Navy, and three Air Force). They represented a total sales value in excess of $220 million and thirteen different contractors were involved.

C. TEST REVISIONS

1. Expansion

A review of available correspondence showed that most participants felt that the number of contracts and cases included in the test was too small to provide valid conclusions concerning the feasibility of centralized accounting and disbursing. The initial scope of the test was

deliberately kept small to validate test procedures and ensure that sufficient contract accounting expertise was available at the SAAC to conduct the test. As of May 7, 1980, the SAAC had processed 107 disbursements consisting of 43 payments and 64 commercial invoices, which amounted to $35.5 million for 7 contracts. A preliminary audit report by the Defense Audit Service (DAS) indicated the scope of the test should be increased to approximately 100-150 contracts. Each Service subsequently nominated additional contracts, and "phase II" of the contract transfer process began with the SAAC receiving advance copies of contracts in August 1980.

Initially, some FMS cases were excluded from the test contracts. For example, for Army and Navy contracts, the SAAC was only given one case for each contract. This required the participating contractors to submit three requests for each progress payment: one for direct procurement materiel, one for FMS materiel not included in the test, and one for FMS materiel included in the test. The inclusion of all cases from each contract selected for the test was subsequently approved to remedy this situation.

2. Extension

Originally, the test provided for completing the test, including a final report, within twelve months. The test was to be fully operational by March 1, 1980. However, as of May 1, 1980, all needed information for four (of the sixteen) contracts had not yet been received by the SAAC.

Because of this delayed beginning and the expanded number of contracts involved, the test was extended. Various key milestone dates were rescheduled: the test itself was extended to September 30, 1981. Final reports became due to DSAA from the Services on October 30, 1981. DSAA's final report due date to the ASD(C) was revised to December 21, 1981.

3. Automation

One of the most difficult tasks associated with the test was the provision of management feedback data on a recurring basis to military department financial and procurement activities. Initially, the test team provided feedback to the Services using six unique reporting formats--all were manually produced. Individual report requirements differed in several ways: (1) reporting periods, (2) number of reports required, (3) level of detail, and (4) method of presentation. The Navy wanted its data presented by Accounting Classification Reference Number (ACRN), the Army by Purchase Request Order Number (PRON), and the Air Force by Materiel Program Code (MPC). To support the complexity of these reporting formats, and considering the expanded scope of the centralized test, it became necessary to automate.

The development of a mechanized systems package began in mid-August 1980. The AFAFC base level Burroughs B3700 system was initially utilized to facilitate contractor

payments, maintain contract disbursement histories, and update the status of allotment accounting records. While actual payment procedures were mechanized, the detailed contract accounting ledgers were manually posted. The systems package envisioned the use of the AFAFC IBM 370 and was designed to enhance the mechanized payment procedure by producing B3700 interfacing data, maintaining the status of allotment records, preparing detailed contract ledgers at the contract/ACRN level and producing management feedback reports for each of the Services and DLA.

Initial automation milestones were optimistic and had to be revised several times, but system development continued. A detailed contract accounting master file was developed for each contract, country/case, and ACRN. From this file, all external management feedback, as well as various internal reports and ledgers, could be extracted. Cumulative contract accounting financial data was loaded into the new system (now called CMIS--Contract Management Information System) during the January through March 1981 timeframe. A detailed reconciliation then took place between the manual payment ledgers and the mechanized status of funds ledgers from the B3700 system. Upon completion, and to ensure accuracy and completeness of financial reporting and transaction input, processing was conducted in parallel (IBM 370 and B3700) during the month of June. CMIS was considered

to be successful and the SAAC Test Team became accountable for the system on July, 1, 1981. [Ref. 43]

4. Performance Reporting

The Services' record of various and untimely methods of reporting materiel/service performance has been disclosed by GAO and DAS. Therefore, the test team was directed to develop and test alternative methods of providing standardized, timely, and accurate delivery/performance reporting.

Currently, the Navy assigns a MILSTRIP document number to each end-item, and upon shipment inputs an actual price DD 1517 transaction. Separate DD 1517 transactions are input for each element of add-on cost, such as travel, RDT&E, labor and overhead, etc. Current delivery reporting methods for the Army and Air Force require the test team to input DD 1517 transactions into DIFS for the net disbursements of both contract or progress payments and actual deliveries to the FMS customer. When all costs related to the procurement of an item are known, the Service concerned then inputs a DD 1517 transaction which automatically liquidates progress payments and reports delivery of the item to the customer. [Ref. 44]

Two primary alternative methods of delivery/ performance reporting were proposed for testing. Referred to as "enhanced procedures", they were applicable only to the Army and Air Force. The Army began testing deliveries for

the Dragon missile contract on 1 November 1980. For this portion of the test, progress payments were inputed in the normal fashion and deliveries (at an estimated price) were reported upon receipt of a DD 250. The Army was to reverse the SAAC's estimated input with an actual price once the total item cost had been finalized. The Air Force was scheduled to commence enhanced delivery testing in early March 1981 for the F-5 contract. For this portion of the test, the Air Force was to report a delivery (at estimated price) upon receipt of a DD 250. When the final price was known, the case manager would reverse the estimated amount and enter an actual delivered value. Delivery reporting procedures for the Navy were not altered. Although somewhat cumbersome because of the manual method in which the tansactions are processed, the Navy's reporting procedures appear to work exceptionally well for tracking all aspects of performance in a timely manner. [Ref. 45]

During the course of the test, it became apparent that, to perform enhanced reporting, numerous system changes would have to be made by the Services and/or the SAAC; therefore evaluation of alternatives was limited. The Army's test had come to a standstill July 1981. The SAAC must have, and be able to provide, an FMS document number (or pseudo document number) input for the DD 1517 to allow identification of the item to the Service for updating the final delivery price. Army's method of assigning document

numbers and the procedure for tracking status of items makes it impossible to identify the FMS number on a DD 250 since the majority of FMS contracted items are procured with Army document numbers. FMS document numbers are assigned early in the procurement cycle, but are not provided to contractors unless the items are for direct shipment to the customer. (Army's normal procedure is to have items shipped to a depot for final assembly or subsequent reshipment to the customer.) It is envisioned that this problem could not be solved without extensive procedural revisions and reprogramming. The Air Force F-5 program managers have opted to wait for publication of a revised Air Force regulation; hence this portion of the enhanced reporting test had not yet begun July 1981.

5. Manpower Study

In August 1980, the SAAC asked the AFAFC Management Engineering Branch to develop work standards to determine the manpower requirement for the centralized unit if the centralization concept was adopted by DOD and Congress. A Manpower Study Group (MSG) was subsequently established by DSAA, consisting of Management Engineering Branch personnel and representatives of each of the Services. The MSG was, specifically, to be responsible for projecting manpower requirements for a centralized operation based on data gathered from the test site and any manpower standards/guides furnished by DOD components for similar functions that they

performed. Their results were to be used by another group tasked to conduct an economic analysis.

Several assumptions were made by the MSG in the development of their manpower model: (1) a valid relationship exists between man-hours expended and payments made, (2) the centralized operation will continue to develop and implement ADP procedures, (3) manpower savings resulting from mechanizing manual operations can be estimated with an acceptable degree of accuracy, and (4) during implementation of centralization, contract workload will be transferred to the SAAC incrementally, allowing periodic evaluation of manpower requirements and phased allocation of manpower resources. The man-hour and workload relationship experienced by the SAAC during the four-month period ending February 1981 was used as the basis of an estimating model. Data collected for months prior to November 1980 were considered unusable due to extremely low work center activity. The model was developed using payments as the independent variable. Use of an average workload in an estimating equation indicated a need for approximately 271 manpower spaces. Assuming that centralization of newly acquired contract workload would cover approximately two years, and that seventy-five percent of the workload would be transferred in the first year, a manpower savings due to automation was applied at a twenty percent rate each

year--yielding an estimated need, after automation, for a total of 217 spaces at the SAAC. [Ref. 46]

Several arguments have been presented to discredit the MSG's estimating model: (1) it is based on a population (manual mode) that cannot be extrapolated to another population (greatly increased workload and mechanized operation), (2) measurement of the test organization is not representative because all functions are not being performed in the test that would be required if total centralization were directed, and (3) the test workload does not permit accurate projections of manpower requirements for an expected workload of 10,000 contracts. Realizing that these arguments might have some credence, and that better alternative methods of analysis might exist, the MSG and the participating Services opted to still utilize the existing model. Impetus for this decision appeared to be a requirement to provide needed input to the economic analysis by March 1981.

On 30 June 1981, based on an evaluation of seven months of data, the Manpower Study Group revised their estimated full-scale manning figure from 217 to 166. This figure is fairly close to an independently developed requirement of 128 positions estimated by the test team itself, based on the assumption of a highly automated contract payment system with interface with DIFS and the Services' management information systems.

6. Economic Analysis

In September 1980, the Defense Audit Service (DAS) recommended that an "economic analysis" be conducted regarding the centralized test. [Ref. 47] The SAAC, not having the required expertise, requested the Air Force Cost and Management Analysis Directorate to take the lead in conducting the analysis.

Within DOD, "economic analysis" has a certain meaning. That is, it means: (1) establishing objectives to be achieved, (2) identifying all alternative methods of achieving these objectives, (3) identifying and comparing costs and benefits of these alternatives, (4) identifying risks and sensitivities of the various alternatives, and (5) making a recommendation upon which management can base a decision. In order to constrain the possible alternatives, DAS was requested to clarify their meaning of the expression "economic analysis". Their clarification indicated that what was wanted was a comparison of the costs and benefits of the current method of operations versus the proposed centralized concept. Thus, an Economic Analysis Working Group was formed, with representatives of all Services and DLA, to compare the current method and only one proposal. The Assistant Secretary of Defense (Comptroller) (ASD(C)) directed that the study must be completed by 30 September 1981. [Ref. 48]

D. CURRENT STATUS

As of 30 June 1981, the three Services had nominated an additional 150 contracts for the centralized test. Phase II contract transfer status is portrayed in Table I. The Army, which had originally specified thirty-nine contracts for transfer, decreased that number to twenty. When concern was voiced that the Army might not have a representative sample to achieve a valid test evaluation, they nominated an additional three contracts.

The completion date for the Phase II contract transfer was 1 November 1980. Transfer is still not complete. This is causing considerable difficulty in processing timely payments, and result in the reporting of incomplete management feedback to the Services. Non-return of obligational authority (OA) to the trust fund has impacted heavily on program and case managers, primarily by causing a considerable delay in responding to CCA requests for certain cases. Another problem is caused by the incomplete transfer of disbursement histories from previous DCASR paying stations and the incomplete transfer of accountability from the previous Air Force accountable stations. Until both transfers are complete, the test team will not have an accurate record of disbursements, and Services will not receive correct case/contract financial status. Table I also points out that relatively few audit reports have been received from the Air Force. Without an audit, it is extremely difficult to determine a contract's financial position.

TABLE I

STATUS OF PHASE II CONTRACT TRANSFER

30 June 1981

EVENT	NAVY	ARMY	AIR FORCE
Number of Contracts Nominated	41	23	86
Advance Copies Received	41	20	76
CCA Issued for Contracts Received	41	20	84
Modifications to Contracts Received	41	20	84
Transfer of Disbursement Histories	36	20	73
Audits Received	39	20	5

Source: SAAC Quarterly Report on Centralized FMS Accounting
24 July 1981

VII. CENTRALIZATION TEST--EVALUATION

> Of all the managerial functions which executives perform, whether at top, middle, lower, or even worker levels, the act of making a decision is without equal in importance--that is to say, the act of making the right decision about the right problem or opportunity. [Ref. 49]

A. BASIC ORGANIZATION

1. Background and Basis of Test

The background leading to the centralization test at the SAAC has been described in earlier chapters. Poor financial management of the FMS program stemmed from an exponential growth in foreign sales and the inability of each of the military services to separately cope with rising problems. Time and again, the GAO reported to Congress on Defense's inability to master the situation. Hoping to have finally hit upon the solution, GAO purported centralization as the ultimate answer. Hence, Defense was directed to develop a plan of centralization. Importantly, it had to ensure full-cost recovery, and a system separate and distinct from all others was to be developed if possible.

2. Test Objectives

With this direction, DOD devised a plan of action centering around a limited test of centralized management. The objectives of the test, outlined in the previous chapter, included: feasibility, advantages and disadvantages, system

development, and resource determination. Defense also wanted the test to determine the degree of centralization that would yield the highest benefit for the resources supplied. This last objective is of the format frequently found in a cost/benefit analysis.

B. EVOLUTION

As the test developed, and various problems surfaced, the plan and its implementation milestones were altered. Delivery/performance reporting, for example, has become a key issue. Enhanced reporting procedures were developed for two of the three Services, but implementation has been halting and slow. Another issue of growing importance is the "economic analysis", which has been reduced to a cost comparison between centralization and the current method of doing business.

C. RESULTS

1. Disbursements

A comparison of detailed accounting records and trust fund records has revealed major differences. The extent, possible causes, and results of these differences were discussed in Chapter IV. Under pre-test conditions, disbursements were made by numerous Service disbursing activities (or DCASRs). Delayed transaction reporting was a major cause of the disparity between detailed sales case accounting records and trust fund accounts. Direct-cite

procurement cases, under the centralized test, are paid by the SAAC. Disbursements are recorded in both areas simultaneously now, vastly reducing the amount of reconciliation necessary for adequate visibility and control. Through June 1981, in excess of $1.25 billion had been disbursed by the centralized activity against the test contracts.

2. Feedback Reporting

Management information reports have long been provided by local accounting activities. Under the centralized test, the SAAC is responsible for these reports. The Services actually participated in the design and refinement of the reports by providing their information requirements. Initially produced manually, the reporting has since been mechanized. Responses from both project officers and other recipients concerning the adequacy, timeliness, and format of the management reports have indicated satisfaction to date. [Ref. 50]

The test team is currently looking beyond existing processing methods and report formats to develop a more standardized and efficient system. Such a system is envisioned to provide magnetic tape interfaces with each of the Service's automated management systems. However, the implementation of a mechanized system of interface has been deferred. The use of MILSCAP reporting has been determined to offer the most expeditious method of transmitting

standardized contract payment and delivery data. Transmission of CPN information via MILSCAP has been tested successfully with the Air Force's Acquisition Management Information System (AMIS). However, the Army and Navy still prefer CPN updates via magnetic tape. Standardization of input formats will require a massive restructuring of the CMIS master file to include MILSCAP data elements. Following the restructure, CPN data will be produced and validated mechanically with only minimal manual intervention.

3. Contract Funding

Obligational authority (OA) is retained at the SAAC under the centralized test. Contractual Commitment Authority (CCA) is issued to the Services' procurement activities in its place. Under the previous system, OA was issued to Service accounting activities, and finance offices were required to certify all procurement documents. Expenditure authority (EA) is also retained at the SAAC under the test, rather than being issued to Service accounting activities. These procedures have significantly reduced or eliminated the long funding chains previously existing and have shortened the resulting time lags in authority and reporting.

4. Problems

The slowness of progress being made in the transfer of all Phase II contracts to the SAAC has led to several problems. These were highlighted in the previous chapter. The project officers have indicated that immediate action

will be taken to expedite the transfers. Upon receipt of all contracts, audits, and disbursement histories, and the return of OA to the trust fund, the SAAC will be in a position to process payments in a more timely fashion, respond faster to CCA requests, and render the correct financial status of each case/contract to the military departments.

The manpower study, being conducted to determine personnel requirements, now shows a need for 166 full-time employees at the SAAC. The test team feels that only 128 positions will be required to centralize the processing of all direct-cite procurement contracts. Different assumptions have been made leading to these two estimates. The primary causes of this divergence are: (1) the use of different numbers of contracts to be inputed within a two-year period, and (2) the test team's assumption of the use of an automated contract payment system with interface with DIFS and the Services' management information systems. Each of the Services is concurrently estimating manpower (and costs) for operations external to the SAAC in the event that centralization is pursued.

A considerable amount of work has been accomplished towards enhancing performance reporting to the military Services. The development and status of these efforts is contained in the previous chapter. In summary, enhanced delivery/performance reporting was originally contemplated for all Services. Later, only the Army and Air Force were

scheduled to be tested--the test team felt that existing procedures employed with the Navy worked exceptionally well, and major changes were not thought necessary. Currently, both Army and Air Force tests have come to a standstill.

5. Objective Achievement

a. Feasibility

The determination of feasibility and applicability of a centralized concept to the FMS program was a prime objective of the centralized test. It was constructed to examine the process as applied to a significant number of different kinds of contracts from each of the Services. Centralized receipt reporting, disbursement procedures, accounting, and performance reporting have been included in the test. Results, to date, have conclusively shown that it is possible to consolidate the accounting and financial management of direct-cite procurement contracts, at least to some degree involving a limited number of contracts/cases.

b. Resource Determination

Another objective of the test has been to estimate the resources required to conduct business in a centralized mode. The SAAC, in conjunction with the Services, DLA, and DSAA, are currently conducting studies to produce this information. The Manpower Study Group (MSG) has examined several months of data, made assumptions regarding future case loads (if centralization is adopted) and

implementation rates, and extrapolated, producing an estimated personnel requirement for the centralized unit. Military Services are also conducting studies to determine the manning effect of centralization within each department.

The personnel estimates, when finalized, are to be a major input of the "economic analysis"--in reality a comparison between centralization and the current way of conducting business. Other "costs" are being examined to this effort, not only dollars and personnel, but other resources: including time, computer usage and programming, equipment, and others.

c. Advantages/Disadvantages

Many, although not all, of the advantages and disadvantages purported by centralization have been examined by the test. A reduction of reconciliation requirements between trust fund accounts and detailed sales case accounting records is evidenced by simultaneous posting procedures at the centralized activity. The status of foreign funds (at least those concerning the contracts/cases within the test) is enhanced by the new procedures. This is mainly due to a decreased authorization and reporting chain and the existence of the centralized disbursing function. On the negative side, the problems inherent in converting to a new system have been apparent. Besides the need to iron out system development wrinkles, chief among these problems was

the need to maintain dual systems while debugging the new CMIS at the SAAC.

There were some advantages, claimed by backers for centralization of FMS, that are not supported by the test results. The advantage of direct-cite versus reimbursable accounting is one such claim. Until both systems are tested, it would be difficult to make a comparison. Another, which is unsupportable, concerns expenditure projections. Although it can be seen that centralization does involve a degree of"shortcutting", a claim of more precise projections (as a result of eliminating echelons involved in their development) is indefensible by such a narrow test--i.e., the examination of solely direct-cite procurement transactions.

d. System Development

Foreign Military Sales directives generally reflect the AECA, calling for pricing and management to ensure that the U.S. Government recovers full costs and operates the FMS program on a no-profit/no loss basis. Accounting and disbursing systems developed during the centralized test do not guarantee compliance with these requirements. Direct-cite procurement case accounting is still largely dependent upon inputs, pricing, and reporting from the military departments. Reimbursable accounting is also unaffected by the test, and the opportunity for U.S. Government subsidation of foreign sales remains.

e. Degree of Centralization

Determining the degree of centralization that will yield the greatest benefit for the resources invested is a primary objective of the test. Two general areas of study are attempting to answer this question: (1) the "economic analysis"/cost comparison, and (2) investigation of other alternatives. Neither of these alone will provide the needed information. Each is being analyzed separately, and there is no evidence indicating that a combined analysis, utilizing the same underlying assumptions and decision factors, is progressing. [Ref. 51]

D. RATIONALE FOR CENTRALIZATION

Limitation of the centralized test solely to direct-cite procurement contracts/cases has similarly limited the test's support for centralization. The elimination of the reporting of nonstandard accounting data is not accomplished, nor has pricing for full-cost recovery been affected by the test.

That is not to say the test is not contributing to the centralization of FMS concept. Consolidated accounting and disbursing has led to less fragmentation and more cooperation between the Services. Further, simultaneous posting of transactions to the trust fund and detailed sales case accounts greatly diminishes the need for reconciliation. An added benefit shown by test results, even barring the problems encountered in the transfer of test cases, is the

reduction in lag time of reporting and recording expenditures, thus increasing the validity of status and accounting reports rendered foreign governments.

VIII. SUMMARY, CONCLUSIONS, AND RECOMMENDATIONS

The tremendous growth in foreign sales, and many of the problems the Department of Defense has had in managing its FMS program, have been noted. The GAO has repeatedly pointed out deficiencies in the program. Efforts to correct the situation have, to this point, been piecemeal.

The General Accounting Office (GAO), in May 1979, highlighted problems and recommended centralization as the best long-range solution. Defense subsequently directed a test of the centralized concept, involving several major direct-cite FMS contracts. Under the direction of DSAA, the test has been conducted at the SAAC. All Services and the DLA have rendered assistance. Operating procedures were developed to accept and combine test data from each Service. Selected contracts, accountability, and paying responsibility were transferred to the SAAC, which then became responsible for accounting and feedback reporting to the departments concerned.

The test has not produced sufficient evidence to support the many advantages of centralization purported by the GAO. This may, to some extent, be attributed to the limited scope of the test--ie., only direct-cite contracts, not reimbursables, were considered. Improved expenditure projections and better programwide planning have not

resulted; but again, the test's narrow scope precludes such impacts affecting the entire program. Since pricing does not fall under the control of the SAAC, centralization cannot, as yet, assure that all costs properly chargeable to the FMS program are fully recovered. Multiple input formats are still utilized by the Services, although, once received by the SAAC, information is uniformally restructured. One of the biggest advantages realized through testing, has been the effect of a centralized, dual posting of transactions to both accounting and cash records. This vastly reduces efforts required to reconcile trust fund accounts and detailed sales case accounting records. Another benefit realized through the centralization of direct-cite procurement contracts is a reduction of the time required to post and update transactions affecting (and hence increase the accuracy of) foreign sales accounts. Faster accounting and financial reporting can be directly attributed, at least in part, to the shortening of funding authority and disbursement chains. Retention of authority (both OA and EA) and disbursements by the SAAC have resulted in contractors receiving their payments quicker and foreign governments being billed faster.

Although not yet completed, the test has already lent a degree of relevancy to the concept of centralization of FMS management and accounting. The feasibility has certainly been established. What remains, is to determine whether

centralization is better than separate systems. An examination of other alternatives, and comparison against centralization, also remains to be seen. Further study in these areas should be the subject of a follow-up thesis.

In a Project Officers' Meeting in April 1981, the test team encouraged members to recommend to DSAA that the decision on centralization be made earlier, as soon as June 1981. Their position was, that for fourteen months, procedures were tested, studied, retested, and restudied to evaluate the significant issues associated with centralized FMS accounting and disbursing for direct-cite contracts. They felt that further testing would add little to the decisionmaking process. Service representatives, however, felt no need to push for an early decision, and no change was recommended to the current milestone plan. [Ref. 52]

Pending final test results and a decision on centralization, a hard look at the situation is advisable. Without centralized management and accounting, or some other new development, the FMS program is in trouble. The problems and difficulties facing Defense have been addressed. The program is not operating on a no-profit/no-loss basis, and DOD has been frequently charged with subsidizing foreign sales with U.S. funds. Centralization appears to be a step forward in controlling the FMS program. A comparison test is being conducted between current procedures and centralized procedures. Costs, in personnel, resources, and dollars, may

determine the "better" system. Accuracy, accountability, and control are also important. Compliance with the AECA, and a proper accounting of foreign funds in United States' custody, should be paramount in the decision. By law, the costs of conducting our FMS program, regardless of the chosen method, are payable by foreign customers. Therefore, system cost should not be an overriding factor.

It is recommended that the test of centralization of direct-cite procurement contracts be run to its scheduled completion. Its results should be compared, not only with current procedural costs and benefits, but also with any known feasible alternatives to centralization. Comparison should be made on a like basis if at all possible, ie., similar assumptions and like data input. Barring the existence of a more favorable alternative, or the unexpected occurrence of a large insurmountable problem with the test, centralization of direct-cite contracts should be implemented at the SAAC on an expanded basis. A program of phased growth, gradually increasing acceptance of the number of contracts/cases involved, should be pursued. It is further recommended that analysis of alternatives should be continued during the implementation of centralization of direct-cite procurement contracts. When the program has been completely established, and is determined to be working smoothly, testing of further centralization should begin. Unless a better alternative is found, implementation and expansion of

centralization should be pursued as the most viable means of improving the existing situation. Only through the complete and total centralization of accounting and disbursing for the FMS program can all of GAO's purported advantages of centralization be realized.

Although centralization is not a panacea for all the ills of the U.S. Foreign Military Sales Program, it is an advancement. It is not reasonable to expect centralization to bring about instant cures. It should be implemented slowly and gradually; it should be tested, and its results analyzed--it is a long-term solution. Something must be done, however; too many problems have been brought to light. Our FMS program is expanding. The situation is a potentially embarrassing one to the United States. To ignore the problems, not to seek advancement, might well leave the United States open to charges of belittling the importance of foreign military sales in favor of the management of other U.S. programs.

APPENDIX A

GLOSSARY OF ACRONYMS

ACF	Accounting and Finance Office
ACRN	Accounting Classification Reference Number
AECA	Arms Export Control Act
AFAFC	Air Force Accounting and Finance Center
AMIS	Acquisition Management Information System
ASD (C)	Assistant Secretary of Defense (Comptroller)
ASD ISA)	Assistant Secretary of Defense (International Security Affairs)
CCA	Contractual Commitment Authority
CLIN	Contract Line Item Number
CMIS	Contract Management Information System
CPN	Contract Payment Notice
DAS	Defense Audit Service
DCASRs	Defense Contract Administration Services Regions
DIFS	Defense Integrated Financial System
DLA	Defense Logistics Agency
DOD	Department of Defense
DSAA	Defense Security Assistance Agency
EA	Expenditure Authority
FMS	Foreign Military Sales
GAO	General Accounting Office
IMET	International Military Education and Training

LOA	Letter of Offer and Acceptance
MAP	Military Assistance Program
MASM	Military Assistance and Sales Manual
MILSCAP	Military Standard Contract Administration Procedures
MILSTRIP	Military Standard Requisitioning and Issue Procedures
MPC	Materiel Program Code
MSG	Manpower Study Group
OA	Obligational Authority
OMB	Office of Management and Budget
PCO	Procuring Contracting Officer
PRON	Purchase Request Order Number
SAAC	Security Assistance Accounting Center

LIST OF REFERENCES

1. Cullin, W. H., How to Conduct Foreign Military Sales, American Defense Preparedness Association, 1980, p. II-2.

2. "The Case of the Misplaced $30 Billion", Business Week, 24 July 1978, pp. 155-156.

3. Ibid.

4. General Accounting Office, Centralization: Best Long-Range Solution to Financial Management Problems of the Foreign Military Sales Program, FGMSD-79-33, 17 May 1979, pp. 3-6.

5. Ibid., p. 7.

6. Assistant Secretary of Defense (Comptroller), "Plan for Centralized FMS Accounting", Memorandum for Secretaries of the Military Departments and Director, Defense Security Assistance Agency, 26 November 1979, pp. 1-2.

7. Kissinger, H. A., American Foreign Policy, W. W. Norton and Co., Inc., New York: 1977, p. 204.

8. U.S. Department of Defense, Department of the Navy, The Naval Material Command Security Assistance Program and Support Planning Manual, NAVMATINST 4900.22, 27 October 1980, p. 1-3.

9. Cullin, Sales, p. II-2.

10. DOD, NAVMATINST 4900.22, p. 1-1.

11. Cullin, Sales, p. VII-2.

12. Rudd, G. A., "Financial Management of Security Assistance in the 1980's", Perspectives in Security Assistance Management, June 1980, p. 56.

13. Ibid., p. 57.

14. Defense Institute of Security Assistance Management, The Management of Security Assistance, DISAM, Wright-Patterson AFB: 1980, pp. 16-4, 5.

15. Assistant Secretary of Defense (Comptroller), "Financial Management of the Foreign Military Sales Program", Memorandum for Secretaries of the Military Departments and Directors of Defense Agencies, 17 June 1977, p. 2.

16. DISAM, Management, p. 16-6.

17. Ibid., p. 21-7.

18. General Accounting Office, Correct Balance of Defense's Foreign Military Sales Trust Fund Unknown, FGMSD-80-47, 3 June 1980, p. 7.

19. ASD(C) memo, "Financial Management", pp. 1-2.

20. General Accounting Office, The Department of Defense Continues to Improperly Subsidize Foreign Military Sales, FGMSD-78-51, 25 August 1978, p. 1.

21. General Accounting Office, Summary of Efforts to Recover U.S. Government Costs in Foreign Military Sales, ID-77-56, 27 September 1978, p. 8.

22. General Accounting Office, Improperly Subsidizing the Foreign Military Sales Program--a Continuing Problem, FGMSD-79-16, 22 March 1979, p. 3.

23. GAO, DOD Continues to Subsidize, pp. 1-2.

24. Ibid., pp. 10-13.

25. GAO, Balance of Trust Fund Unknown, p. 7.

26. Ibid., pp. 11-13.

27. Ibid., p. 14.

28. GAO, Centralization, p. 6.

29. GAO, Subsidizing FMS--Continuing Problem, p. 7.

30. Hall, R. H., Organizations: Structure and Process, Englewood Cliffs: Prentice-Hall, Inc., 1977, p. 193.

31. GAO, Centralization, pp. 8-9.

32. Ibid., p. 12.

33. GAO, Subsidizing FMS--Continuing Problem, p. 9.

34. GAO, Centralization, p. 12.

35. U.S. Congress, House, Committee on Appropriations, Department of Defense Appropriation Bill, 1980, 96th Congress, 1st session, 20 September 1979, p. 218.

36. Ibid., p. 217.

37. ASD(C) memo, "Centralized FMS Accounting", pp. 1-2.

38. Security Assistance Accounting Center, Fact Sheet, 1981. (Typewritten).

39. Director, Defense Security Assistance Agency, "Memorandum for the Assistant Secretary of Defense (Comptroller), 31 December 1979, pp. 1-4.

40. Security Assistance Accounting Center, "Centralized Accounting and Disbursing for FMS Direct Cite Procurement", (manual of operating instructions), Air Force Accounting and Finance Center, 25 August 1980, Appendix B.

41. Ibid., p. 2-1.

42. Ibid, pp. 4-1, 2, 3.

43. Security Assistance Accounting Center, "Quarterly Report on Centralized FMS Accounting", Memorandum for DSAA, 24 July 1981, p. 4.

44. Centralized FMS Accounting and Disbursing Test, Minutes of Project Officers' Meeting, 17-18 February 1981. (Typewritten.)

45. Centralized FMS Accounting and Disbursing Test, Minutes of Project Officers' Meeting, 7-8 April 1981. (Typewritten.)

46. Ibid.

47. Defense Audit Service, Interim Report on the Review of the Test of Centralized Accounting and Disbursing for Foreign Military Sales Direct Cite Procurements, No. 80-139, 24 September 1980, p. 3.

48. Assistant Secretary of Defense (Comptroller), "Centralized FMS Accounting and Disbursing Test", Memorandum for Comptroller, Defense Security Assistance Agency, 21 October 1980, p. 1.

49. Cornell, A. H., The Decision-Maker's Handbook, Englewood Cliffs: Prentice-Hall, Inc., 1980, p. 13.

50. SAAC, "Quarterly Report", p. 4.

51. Project Officers' Meeting, 7-8 April 1981.

52. Ibid.

INITIAL DISTRIBUTION LIST

		No. of Copies
1.	Defense Technical Information Center Cameron Station Alexandria, Virginia 22314	2
2.	Library, Code 0142 Naval Postgraduate School Monterey, California 93940	2
3.	Assoc. Professor Shu S. Liao, Code 54Lc Department of Administrative Sciences Naval Postgraduate School Monterey, California 93940	1
4.	Adj. Professor William H. Cullin, Code 54Ck Department of Administrative Sciences Naval Postgraduate School Monterey, California 93940	1
5	LCDR Roger A. Willis 17635 East Belleview Place Aurora, Colorado 80015	2

Thesis 195578
W62795 Willis
c.1 Centralized accounting and disbursing for foreign military sales direct-site procurements: test evaluation
14 JUN 84
5 FEB 87
29283
33518

Thesis 195578
W62795 Willis
c.1 Centralized accounting and disbursing for foreign military sales direct-site procurements: test evaluation.

thesW62795
Centralized accounting and disbursing fo
3 2768 001 90113 5
DUDLEY KNOX LIBRARY